COORS ENERGY CO.

IBLA 87-336 Decided September 11, 1989

Appeal from a decision of the Colorado State Office, Bureau of Land Management, refusing to exclude unleased Federal lands from participating in the Hamilton Unit Agreement, San Miguel County, Colorado. CO-922.

Reversed.

1. Oil and Gas Leases: Unit and Cooperative Agreements

   A unit agreement may not be unilaterally reformed by BLM to include land which has not been committed to the unit agreement.

2. Oil and Gas Leases: Compensatory Royalties -- Oil and Gas Leases: Competitive Leases -- Oil and Gas Leases: Drainage -- Oil and Gas Leases: Unit and Cooperative Agreements

   Where an unleased tract has been determined to be within a participating area pursuant to an approved unitization plan, revenues attributable to the tract held in escrow pursuant to the plan may not be used by BLM to secure a favorable bargain under competitive leasing requirements.

3. Oil and Gas Leases: Unit and Cooperative Agreements

   Lands not committed to a unit agreement may not participate in any production from unitized lands.

4. Oil and Gas Leases: Drainage -- Oil and Gas Leases: Unit and Cooperative Agreements

   Unleased Federal lands determined to be productive in paying quantities as part of a unitization plan may not be considered "unitized" to protect the uncommitted land from drainage.

5. Oil and Gas Leases: Unit and Cooperative Agreements

Once a unit operating agreement has become effective BLM lacks authority to amend the agreement without the parties' consent.

APPEARANCES: Laura Lindley, Esq., Denver, Colorado, for appellant; Lowell L. Madsen, Esq., Office of the Regional Solicitor, Denver, Colorado, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Coors Energy Company (Coors) is unit operator for the Hamilton Unit Agreement, an oil and gas unitization agreement entered into by various owners, lessees, and working interest owners for the joint operation of a prospectively productive oil and gas field located on leased Federal, State, and patented lands in San Miguel County, Colorado. The Hamilton Unit Agreement became effective September 1, 1983; Coors succeeded Shell Oil Company as unit operator on February 6, 1984. Under the unit agreement approved by the Bureau of Land Management (BLM) on September 1, 1983, Federal lands comprise approximately 75 percent of the Hamilton Unit; 20 percent of the lands are owned by the State of Colorado; the remaining 5 percent of the unit embraces patented lands.

Coors has appealed from a decision of the Colorado State Office, BLM, denying its application to revise the Upper Hermosa Formation Participating Area "A" in conformity with its tendered Exhibit B-3, which would exclude portions of Tract 46A currently included in the participating area under approved Exhibit B-1. Tract 46A is an unleased Federal tract located at S 1/2 SW 1/4, SE 1/4, sec. 25, T. 45 N., R. 15 W., New Mexico Principal Meridian. Appellant argues that since Tract 46A is unleased, it is not committed to the unit; therefore the unit operator is under no obligation to hold revenues attributable to Tract 46A for either the Federal Government or a future lessee.

BLM's approval of Exhibit B-3 would lessen the size of the Upper Hermosa Formation Participating Area by 200 acres, and would reallocate all revenues attributable to Tract 46A among the remaining working interest owners. These revenues are currently held in an interest-bearing escrow account pursuant to agreement between BLM and appellant as set forth in Exhibit B-1.

Underlying the creation of the escrow account for allocation of production to Tract 46A are circumstances previously before this Board in an appeal by Hrubetz Oil Company, decided on September 11, 1986. See Hrubetz Oil Co., 93 IBLA 343 (1986). Hrubetz dealt with a case where, in May 1983, prior to formation of the Hamilton Unit, BLM listed a tract of land, parcel CO-310, comprising approximately 800 acres in secs. 23, 24, and 25, T. 45 N., R. 15 W., New Mexico Principal Meridian, as available for simultaneously filed oil and gas lease applications. As a result of a July 6, 1983, drawing, Hrubetz Oil Company obtained first priority to lease the tract.

Subsequent to formation of the Hamilton Unit on September 1, 1983, and to completion of the first well on January 25, 1984, BLM notified Hrubetz on February 2, 1984, that it had 30 days within which to return a lease offer to BLM with the required rental. BLM informed Hrubetz that all or part of parcel CO-310 was within the Hamilton Unit, and that it should file evidence with BLM within 60 days as to joinder, or state why joinder would not be possible. Ratification and joinder of Hrubetz to the Hamilton Unit was accepted for unit purposes by BLM on April 27, effective May 1, 1984, stating that the tract "will be fully committed upon lease issuance." The lease, however, did not issue at that time. The Hrubetz tract was designated in the unit agreement as "Tract 46."

On June 4, 1984, appellant submitted an application for approval of an initial participating area as a result of the January 25, 1984, completion of an initial unit well capable of production. This application, with amendment, was approved by BLM on July 9, 1984, effective January 25. The initial participating area encompassed 640 acres located in Tracts 18, 46, and 49. Production commenced from the initial unit well, State 1-36H, located in Tract 49, on August 2, 1984.

On November 26, 1984, BLM classified 240 acres of Tract 46 as part of a known geologic structure (KGS), and Hrubetz was notified on December 24, 1984, that its offer was rejected for land included within the KGS, holding that such lands could only be leased under competitive bidding procedures. A lease issued to Hrubetz on January 1, 1985, for the parcel outside the KGS boundaries. As to the land within the KGS, Hrubetz initiated an appeal in January 1985, which was denied in Hrubetz Oil Co., supra.

For purposes of the unit agreement, the portion of Tract 46 determined to be within the KGS was redesignated Tract 46A. Tract 46A consists of the S 1/2 SW 1/4, SE 1/4 of sec. 25, T. 45 N., R. 15 W. After completion of a second unit well, State 1-30H, in the SE 1/4 SW 1/4 of sec. 30, T. 45 N., R. 14 W., which began producing on November 8, 1984, appellant proposed to revise the Upper Hermosa Formation Participating Area "A" on March 18, 1985, to include all of Tract 46A except the SW 1/4 SW 1/4 of sec. 25. BLM approved the initial participating area and the first revision in April 1985, effective September 1, 1984.

In its March 8, 1985, application to enlarge the initial participating area, inquiry was made by appellant concerning the distribution of revenues attributable to the unleased Tract 46A. Appellant submitted three exhibits with the proposed revision; Exhibit B-1 allocated participation to Tract 46A as unleased; Exhibit B-2 allocated participation to Tract 46A with Hrubetz as lessee; Exhibit B-3 allocated no participation to Tract 46A, treating it as unleased and uncommitted.

On April 10, 1985, BLM advised appellant that the proper method of handling distribution of revenues from the unleased Federal tract included in the revised participating area was to place 100 percent of its allocable revenues in an interest-bearing escrow account. Appellant was informed that all revenues previously distributed to Minerals Management Service for this unleased tract should be refunded, and that "[d]ue to the uncertain outcome

of the IBLA appeal and the length of time that might be involved, we will hold in abeyance your recommendation to utilize the Exhibits B-2 and B-3 until the appeal process has been completed." Id.

Accordingly, revenues attributable to Tract 46A were placed in escrow by appellant in conformity with Exhibit B-1. On November 10, 1986, after the Board determined that Hrubetz was not entitled to noncompetitively lease Tract 46A, appellant applied to BLM requesting that its Exhibit B-3 be approved treating Tract 46A as uncommitted to the Hamilton Unit and not entitled to an allocation of production. Appellant's application for approval of Exhibit B-3 was denied by BLM on February 18, 1987, and this appeal ensued.

The revised participating area, according to approved Exhibits "A" and "B-1" of the First Revision of the Upper Hermosa Participating Area "A," encompasses 1,481.69 acres, located in Tracts 16, 18, 26, 29, 46A, 49, and 61. Shell Oil Company is lessee and working interest owner of 1,161.69 acres of the total 1,481.69 acreage included in the revised participating area and, according to Exhibit B-1, is entitled to 78.7031 percent of participation. Tract 61 contributes 80 acres to the revised participating area, is leased by Milestone Petroleum, Inc., and receives, under Exhibit B-1, 5.3992 percent of participation. Forty acres of the revised participating area is located in Tract 18, leased by Vincent J. Duncan, et al. Tract 18 receives 2.6996 percent of participation. Under Exhibit B-1, Tract 46A contributes 200 acres to the participating area and is entitled to 13.4981 percent of participation.

Under Exhibits "A" and "B-3," Shell Oil Company would own a working interest in 1,161.69 acres of the total 1,281.69 acreage included in the revised participating area, and would be entitled to 90.6373 percent allocation. Tract 61, the 80-acre tract leased by Milestone, would receive 6.2418 percent allocation; Tract 18, the Duncan lease, would receive 3.1209 percent. Tract 46A, listed as uncommitted, would receive no allocation of participation.

In its February 18, 1987, decision denying approval of Exhibit B-3, BLM stated that its policy is to consider unleased Federal land unitized when it is contained in a participating area. According to BLM, "[t]he reasons for this policy are twofold:"

> 1. Unleased federal land contained in a unit area is considered unitized acreage which is under the "effective control" of the unit operator since, prior to lease issuance, the lease applicant is required to file evidence that an agreement has been entered into with the unit operator for development and operation of the land pursuant to the terms and provisions of the unit agreement, or to file a statement giving just cause for failing to enter into such agreement pursuant to 43 CFR 3101.3-1. This idea of "effective control" by the unit operator is reinforced when a unit agreement is being considered for approval. Unleased federal land can be utilized when determining if more than 85 percent of the land in the unit area is controlled by the unit operator.

> 2. Even though other working interest owners in the participating area may pay for the drilling of the well discovering unitized substances in paying quantities, this does not entitle them to any revenue generated by oil and gas production which is attributable to and being drained from the unleased federal land contained in the approved participating area. Once again, the determination as to how much of the unitized production can be attributed to the unleased federal land is made when the participating area is approved and will be reflected on the corresponding Exhibit "B."

Id. at 1-2. Approval of tendered Exhibit B-3, BLM opined, would be equivalent to a determination that "the unleased federal lands contained in the participating area are not reasonably productive of unitized substances in paying quantities." Id. at 2.

According to BLM's decision, the future lessee of Tract 46A would, by the terms of the agreement with BLM, be required to join the unit, and would be entitled to revenues attributed to its share of the total production, less costs of production also allocable pursuant to the unit operating agreement, and less royalties. Id. The lessee would not, however, be subject to a nonconsent penalty "for the purpose of escalating drilling and operating costs since, at the time when the participating area unit well was drilled, the land was unleased and, therefore, the lessee could not make a choice concerning commitment to the drilling of the unit well." Id.

In its statement of reasons (SOR), appellant argues that since Tract 46A is unleased, the tract is not committed to the Hamilton Unit Agreement, and therefore, is not entitled to an "allocation of production." 1/ Unleased land, appellant contends, is neither committed to nor bound by the unit agreement. Likewise, appellant reasons, since future lessees are not committed to the costs under the unit operating agreement neither should they be entitled to its benefits. 2/ Appellant further charges that BLM's determination in the April 18 decision that "its eventual lessee 'is not subject to a nonconsent penalty'" interferes with the terms of the unit operating agreement, and that BLM has therefore exceeded its authority by attempting to modify the terms of a private agreement. 3/

Appellant argues that, by denying approval of Exhibit B-3, monies which would be disbursed under the unit agreement are being sequestered by BLM in order to extract a larger bonus from a prospective lessee. By denying working interest owners the opportunity to drive a fair bargain through use of a nonconsent penalty, appellant charges that BLM has exceeded its authority by intervening in negotiations under the unit operating agreement, an essentially private matter.

1/ SOR at 5.
2/ SOR at 7-8.
3/ SOR at 12-15.

In a June 15, 1987, letter to the Board, appellant frames the issue to be determined by the Board as

> whether any production from a unit participating area is allocable to unleased * * * federal lands, and second, whether the Bureau of Land Management has any authority to interfere with the terms of the unit operating agreement with respect to the conditions on which its eventual lessee may be permitted to join the unit.

BLM characterizes the issue to be determined as whether an interest-bearing escrow account can be established for allocation of production to unleased Federal land if the unleased land is recommended for inclusion in a participating area. 4/ Without the escrow protection, BLM contends, Tract 46A will be drained without payment of royalties due, which undermines the public interest policy behind unitization for extraction of oil and gas on Federal lands. In a July 13, 1988, memorandum submitted in response to a letter from appellant dated June 22, 1988, BLM denied uses for the escrow account other than "to protect its royalty interest in lieu of successfully leasing the lands, as evidenced by its April 10, 1985 letter to appellant." 5/

The bedrock issue underlying the position advanced by each of the parties is whether and to what extent BLM has discretionary authority to require a unit operator to include unleased Federal lands within a participating area, notwithstanding that the lands and the substances they yield are not committed to the unit agreement and the unit operating agreement through the usual ratification and joinder by a lessee and working interest owner.

4/ BLM's notice dated June 8, 1987, states,

"The only question raised by this appeal is whether the BLM can require the unit operator to deposit in an interest bearing escrow account 100 percent of all of the revenues that would be allocatable to the unleased Federal land if it were leased whenever that land is recommended for inclusion in a participating area." (Emphasis added.) The context requires us to construe this statement to include the subjunctive "as" before "if it were leased."

5/ According to BLM's July 13, 1988, memorandum, at page 2,

"The subject unleased federal lands were offered in the August 1987 Competitive Bid Sale. NRG Resources Inc. was the high bidder for this parcel. Prior to lease issuance, this office is requiring that NRG Resources Inc. submit a ratification and joinder instrument to the Hamilton Unit Agreement or show just cause why the lands should not become committed to the unit. Coors Energy Company has refused to acquiesce in the joinder for NRG Resources Inc. until a decision for this appeal is rendered. Without joinder, the lands remained unleased and subject to drainage from the participating area production."

The terms and conditions under which the tract was ultimately offered for lease have not been revealed to the Board by either party.

[1] The Secretary's authority to permit agreements for the purpose of conserving natural resources and collectively engendering production from a prospectively productive oil and gas field located on public lands is found in the Mineral Leasing Act (MLA), at 30 U.S.C. § 226(j) (1982). 6/ The Hamilton Unit Agreement essentially parallels the model unit agreement set forth at 43 CFR 3186.1.

Without a lease, appellant argues, Tract 46 is uncommitted to the unit agreement, does not contain "unitized substances," and therefore is not entitled to an allocation of production. In support of its contention that Tract 46A is not entitled to receipt of monies unless leased, appellant relies on the unit agreement at section 3, which defines "unitized land," and "unitized substances," 7/ and section 12, which limits allocation of production of unitized substances to unitized land. 8/

6/ Section 226(j) provides, in pertinent part:

"For the purpose of more properly conserving the natural resources of any oil or gas pool, field, or like area, or any part thereof * * *, lessees thereof and their representatives may unite with each other, or jointly or separately with others, in collectively adopting and operating under a cooperative or unit plan of development or operation of such pool, field, or like area, or any part thereof, whenever determined and certified by the Secretary of the Interior to be necessary or advisable in the public interest. The Secretary is thereunto authorized, in his discretion, with the consent of the holders of leases involved, to establish, alter, change, or revoke drilling, producing, rental, minimum royalty, and royalty requirements of such leases and to make such regulations with reference to such leases, with like consent on the part of the lessees, in connection with the institution and operation of any such cooperative or unit plan as he may deem necessary or proper to secure the proper protection of the public interest."

7/ Section 3 of the unit agreement provides that "[a]ll land committed to this agreement shall constitute land referred to herein as 'unitized land' or 'land subject to this agreement.' All oil and gas in any and all formations of the unitized land are unitized under the terms of this agreement and herein are called 'unitized substances.'"

8/ Section 12 of the unit agreement governs allocation of production, as follows:

"All unitized substances produced from each participating area established under this agreement, * * * shall be deemed to be produced equally on an acreage basis from the several tracts of unitized land of the participating area established for such production and, for the purpose of determining any benefits accruing under this agreement, each such tract of unitized land shall have allocated to it such percentage of said production as the number of acres of such tract included in said participating area bears to the total acres of unitized land in said participating area, except that allocation of production hereunder for purposes other than for settlement of the royalty, overriding royalty, or payment out of production obligations of the respective working interest owners, shall be on the basis described in the unit operating agreement * * *."

Appellant also cites Board decisions in Duncan Miller, 4 IBLA 274 (1972), and Coors Energy Co., 82 IBLA 212 (1984), in support of its argument that "an uncommitted tract may not receive the benefit of unit operations or production." We agree with appellant that commitment to a unit is generally considered to be a matter of private agreement, and that unleased as well as leased interests who have not attended the requirements for joinder as specified by regulation and by the terms of the specific unit agreement have generally not found the Board willing to grant relief either for purposes of receiving benefits under a unit agreement or for purposes of lease extension. See High Crest Oils, Inc., 29 IBLA 97 (1977); Duncan Miller, supra.

Insofar as appellant's argument assumes that BLM is attempting to reform the unit agreement to include Tract 46A, we are convinced that BLM is without authority to do so. In Shannon Oil Co., 62 I.D. 252, 255 (1955), it was held that "[t]he Secretary of the Interior has no authority to reform a unit agreement, approved by him pursuant to the provisions of the Mineral Leasing Act, to include land which, through error, was not committed to the unit agreement." The Shannon opinion held that the parties could themselves reform the agreement "to state their true intentions in the matter if, in fact, it was their understanding that the tract in question was to be committed to the agreement." Id.

[2] As appellant has noted in its SOR, prior decisions by this Board indicate that commitment to a unit "is accomplished by signing the unit agreement and unit operating agreement" and "[t]he mere action of approving a unit area as suitable for development under a unit agreement does not constitute commitment of unleased Federal acreage therein." High Crest Oils, Inc., supra at 98. In High Crest, we adopted a decision by the Acting Director of Geological Survey (GS), which required High Crest Oils, as unit operator, to submit a revised Exhibit C showing an unleased Federal tract as not committed to Bullhook Gas Unit Area. Title to the Federal tract was uncertain when the unit agreement was formed, but was later settled in the Chippewa Cree Indian Tribe. Id. at 99.

While the GS decision adopted in High Crest is instructive concerning the necessity of a subsequent ratification and joinder to accomplish commitment to a unit under usual circumstances, the Acting Director was careful to distinguish the Bullhook Unit Agreement from instances where drainage is in issue. The Acting Director's decision, Id. at 105, references 30 U.S.C. § 226(g) (1982), which provides for drainage agreements under the Mineral Leasing Act, as follows:

> We need not deal with appellant's arguments regarding to authority of the Secretary of the Interior to effectuate unitization of unleased Federal mineral lands. The Secretary can and has, on occasion, entered into formal contractual arrangements and agreements which have effectively unitized lands covered by the provisions of the Mineral Leasing Act (30 U.S.C. 226 (g)). However, such an agreement was not entered or even proposed in the present case.

> We believe that the Supervisor's view of the commitment status of the mineral interests in Unit Tract 7-B is correct and that unleased mineral interests owned by the United States or held by the United States in trust for the Indian owners of such interests may not be committed to a unit agreement without a specific readily identifiable action on the part of duly authorized Federal officials.

In its SOR, appellant argues, on the one hand, that BLM may pursue a remedy to prevent drainage of Tract 46A, yet asserts that the terms of the unit agreement require BLM to exclude acreage from the participating area such that no participation will inure to the tract. BLM's remedy, according to appellant, is to lease the tract and thus obtain royalties from the effective date of the lease. 9/

Appellant argues that the Board's holding in Bruce Anderson, 80 IBLA 286, 91 I.D. 203 (1984), requires a finding that no revenues "from the Upper Hermosa Formation Participating Area 'A' [may] be allocated to Tract 46A until that tract is leased and committed to the unit agreement, and Tract 46A may participate in such revenues only from that date." 10/ We agree that the Bruce Anderson decision lends support to appellant's position, although, strictly speaking, the case is not directly in point since a communitization agreement was involved in the Anderson decision.

The issue in Bruce Anderson pertained to a lessee's attempt to extend the terms of a lease via the various regulatory exceptions which may be invoked where a noncompetitive lease would otherwise terminate by operation of law upon the running of its primary term. The lessee argued that a communitization agreement was in effect, therefore extending the terms of his lease pursuant to 43 CFR 3105.2-3 (1983); he also argued that he was willing to pay compensatory royalties for drainage pursuant to 43 CFR 3107.9-1 (1982), which would extend the lease term.

Federal regulations pertaining to drainage set forth the scheme outlined in Nola Grace Ptasynski, 63 IBLA 240, 89 I.D. 208 (1982), in which a lessee will be required to protect Federal lands from drainage to the extent that a reasonably prudent operator would do so, after notice to the lessee that BLM has determined the lands are being drained, and that offset drilling or compensatory royalties are required. See Bruce Anderson, supra at 299; Gulf Oil Exploration & Production Co., 94 IBLA 364 (1986).

This appeal, however, concerns a decision denying approval of a proposed revision to a participating area to exclude unleased Federal land. By the very terms of the unit agreement, section 11, a participating area, represents an area "known or reasonably estimated to be productive in paying quantities." Despite this circumstance, appellant's argument that Tract 46A is not committed to the unit and thus not entitled to an allocation of production is well-taken.

9/ SOR at 10, 12.
10/ See note 5, supra.

[3] Unit production may not be allocated to land which is not committed to the unit. Article 3 of the unit agreement defines "unitized lands" as land "committed" to the unit. Article 12 of the unit agreement limits participation in production to lands which have been "unitized." Lands not committed to the unit agreement are, by the terms of the agreement, not entitled to participate in any production from unitized lands. Since Tract 46A is not committed to the Hamilton Unit Agreement, it is not entitled to allocated production under the agreement.

As we stated in High Crest Oils, Inc., supra, "approving a unit area as suitable for development under a unit agreement does not constitute commitment of unleased Federal acreage therein." Id. at 98. We therefore find that BLM lacked authority to require appellant to allocate a share of production from unit lands to Tract 46A, and reverse the refusal by BLM to exclude the unleased Federal tract from participating in the Hamilton Unit Agreement.

[4] The possibility that drainage may occur from the unleased Federal tract is a real concern in this case. Nonetheless, the Department is entitled to no revenue from an unleased tract located within a unit area. See Bruce Anderson, supra. In Anderson we held that unless there were an approved communitization agreement covering the land at issue, the United States could make no claim upon production within the drilling unit where the well was not located on Federal land, because

> [i]n the absence of an approved communitization agreement, the Federal Government has no claim to its pro rata royalty from production of the Dishen #1-17 well, since the State's pooling order is ineffective as to the Federal royalty interest absent the expressed consent of the United States. Nor could the United States sustain a claim for compensatory royalty for the royalties earned prior to lease expiration since * * * the lessee would not be liable for any such royalties at the time the lease expired, absent his expressed commitment to tender the same. Thus, it would seem that the United States has lost any claim to royalties earned by production from the Dishen #1-17 well.

80 IBLA 301-02, 91 I.D. 211-12. This reasoning applies generally to this case as well.

[5] To avoid drainage of the Federal tract, BLM must lease the lands believed affected. In future cases, to avoid a similar problem, BLM may prevent the assessment of penalties by the unit operator by inserting a provision to that effect in the agreement before the parties accept it. It is now, however, too late for BLM to alter the unit operating agreement by inserting such a provision into the agreement after it has become effective. At this point, BLM lacks authority to attempt to modify the agreement so as to condition terms upon which the future lessee of Tract 46A may become a party to the unit agreement. Consequently, BLM's attempt to condition the terms upon which a future lessee of Tract 46A might be admitted to participation in the unit must also be reversed.

[*260] In summary, therefore, BLM must approve appellant's exhibit "B-3" which allocates no production to Tract 46A until it is leased and committed to the Hamilton Unit Agreement. BLM may not now change the terms of the unit agreement, and may not condition the terms upon which a lease of Tract 46A will be admitted to participation in the unit.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is reversed.

Franklin D. Arness
Administrative Judge

ADMINISTRATIVE JUDGE BURSKI CONCURRING:

While in full agreement with the conclusions espoused in the lead opinion, I wish to write separately in order to underline the Board's recognition of the very real concerns that, in situations such as that involved herein, present procedures may not adequately protect the interests of the United States.

Initially, however, I wish to record my firm agreement with the lead opinion that, under the terms of the Hamilton Unit Agreement as well as the relevant regulations, unleased Federal land cannot be considered "committed" to the unit and, as a result, cannot be allocated production from a participating area within that unit.

I think a review of the relevant provisions of the Unit Agreement makes this conclusion inescapable. Thus, Article 3 of the Unit Agreement provides that:

> All land committed to this agreement shall constitute land referred to herein as "unitized land" or "land subject to this agreement." All oil and gas in any and all formations of the unitized land are unitized under the terms of this agreement and herein are called "unitized substances."

Article 12 of the Unit Agreement, which deals with "Allocation of Production," expressly provides that "for the purpose of determining any benefits accruing under this agreement, each such tract of unitized land shall have allocated to it such percentage of said production as the number of acres of such tract included in said participating area bears to the total acres of unitized land in said participating area * * *." It seems clear that, under these provisions, unless the unleased Federal land can be deemed to have been "committed" to the unit, no production can be allocated thereto.

Under prior Board precedent, cited by appellant and referenced in the lead opinion, we have expressly held that "commitment is accomplished by signing the unit agreement and unit operating agreement." High Crest Oils, Inc., 29 IBLA 97, 98 (1977). Indeed, the Board expressly held that mere approval of a unit agreement did not effectuate commitment of unleased Federal land within the exterior boundaries of that unit. Id. And, in this regard, it is salient to note that, in High Crest, we were affirming a decision of the Acting Director, U.S. Geological Survey, which had reached the same conclusion. See also Conservation Division Manual 645.1.3FF.

There seems little dispute that the acreage involved herein was not committed to the Hamilton Unit. Thus, in notifying the Deputy State Director for Operations of the approval of the Unit, the Deputy State Director for Mineral Resources expressly noted that: "Unleased Federal land, comprising Tracts 46, 47, and 48, totalling 1,040.00 acres (4.04 percent), is non-committed, but is considered to be controlled acreage because prior to issuance of leases for that acreage, the lessees will be required to commit to the unit agreement" (Memorandum dated September 1, 1983). It would seem to ineluctably follow, therefore, that no production could be

allocated to the unleased Federal acreage involved until that acreage was expressly committed to the Unit.

In the decision under appeal, Bureau of Land Management (BLM) sought to avoid this result by arguing (1) that, since the eventual lessee will be required to file evidence of unit joinder, unleased Federal land is deemed to be within the "effective control" of the unit operator for the purpose of determining whether sufficient acreage (more than 85 percent) is subject to control, and (2) that

> [e]ven though other working interest owners in the participating area may pay for the drilling of the well discovering unitized substances in paying quantities, this does not entitle them to any revenue generated by oil and gas production which is attributable to and being drained from the unleased federal land contained in the approved participating area.

(Decision at 1-2). In candor, I find neither argument germane to the question whether unleased and uncommitted Federal lands can be allocated unitized production.

The first point, that the acreage is deemed to be within the effective control of the unit operator seems, to my mind, a total irrelevancy to the question of whether the land may receive an allocation of production prior to the time that it is actually committed to the unit agreement.

The second justification confuses two discrete elements. First, the fact that the Federal land may be within the approved participating area does not determine whether or not it receives allocated production. As noted above, production is allocated only to "unitized," i.e., "committed," lands. Since these lands are not "committed," the fact that they may be situated within the physical boundary of the participating area has no bearing on the ultimate question being examined.

Second, the mere fact that oil or gas is being drained from beneath the Federal lands does not, ipso facto, give rise to any claim for compensation. Since oil and gas are fugacious substances, it has long been recognized that ownership is generally determined by the rule of capture. As we noted in Sun Oil Co., 91 IBLA 1, 27, 93 I.D. 95, 109 (1986), "Under this principle, the owner of a tract of land acquires title to the oil and gas only when he reduces the oil and gas to his possession." Thus, the mere fact that oil or gas is being drained by an adjacent well does not give rise to a compensable claim for damages.

Admittedly, it was in an attempt to mitigate various undesirable effects of the law of capture that unitization, among other mechanisms, was originally devised. But, the problem in the instant case is that the Federal land in Tract 46A was not unitized. The fact that, had it been unitized, it would have the right to its aliquot proportion of the production obtained from the well does not give rise to any rights to such production in the absence of commitment of the land to the Unit. There

is simply no way, given the express terms of the Unit Agreement and the applicable regulations, that the production from wells within the Unit can be allocated to non-unitized acreage. See generally, Churchill, "Federal Unitization," 21 Rocky Mt. Min. L. Inst. 223, 238-40 (1975). Thus, the lead opinion is clearly correct in its conclusion that the decision of the State Director refusing to approve appellant's request for approval of Exhibit B-3 cannot be sustained.

At the same time, however, the result which obtains in the instant appeal, namely, the loss of substantial royalties to the United States in those situations in which the Government is unable to expeditiously lease its land, underlines the need for corrective action along the line proposed by the Draft Report of a Bureauwide task force attached to Instruction Memorandum No. 88-419. 1/ After first noting, in accordance with the decision reached herein, that unleased lands which fall within an approved participating area "will not receive an allocation of production, [Rpt. at 34]" the report suggested, inter alia, amending the Model Form Unit Agreement, set forth at 43 CFR 3186.1, so that the first sentence in Section 3 would read "All land now or hereafter committed to this agreement or unleased Federal Land shall constitute land referred to herein as 'unitized land' or 'land subject to this agreement' (emphasis supplied)." I think it is clear that the addition of the phrase "or unleased Federal land" would avoid the problems apparent in this case.

More problematic, however, is the assertion by the State Office of the authority to prohibit the assessment of a nonconsent penalty upon subsequent joinder of the Unit by the eventual Federal lessee. I think appellant is correct that, at the present time, there simply exists no authority by which the State Office can interfere with the imposition of such a penalty as provided for in the unit operating agreement. But I also think that, consistent with the above analysis, the Department could adopt a regulation prohibiting the assessment of nonconsent penalties for subsequent joinder where the Federal interest was unleased at the time of unitization. 2/

1/ I realize that the Colorado State Director has argued that this was merely a draft report and that, in his view, the addition of the language quoted infra in the Model Form Unit Agreement would merely "reinforce our authority to collect royalties due to the United States from participating area production" (Memorandum dated July 13, 1988, from Colorado State Director to Regional Solicitor, Rocky Mountain Region (emphasis in original)). The problem with this position, however, is that it assumes the very point in controversy, namely that royalties are due to the United States where unleased and uncommitted Federal land is within the exterior boundaries of a participating area. As is made clear both in this opinion and the lead opinion, however, absent inclusion of language such as that proposed in the unit agreement or some similar contractual arrangement binding on the parties to the unit agreement, royalties are not due to the United States in such circumstances.

2/ While appellant correctly points out that the Federal Government is not a signatory to the unit operating agreement and has no right to unilaterally alter contractual arrangements between private parties, the same result

Whether such a rule ought to be issued, however, is, a matter of considerable complexity.

On the one hand, it is true, as the decision below pointed out, that the eventual lessee did not have an opportunity to originally join the unit since the land was unleased at that time. Thus, from the lessee's perspective it may seem unfair to, in effect, penalize him for failing to accept an option which he was unable to accept. But there are considerations on the other side of the ledger related to fairness to all working interest owners in those situations in which some of the interest owners decline to participate in the drilling of a well.

Obviously, if drilling is unsuccessful, the nonconsenting party will forego efforts to join the unit and thereby avoid paying any of the drilling costs. It is, as a general rule, only when the well is successful that a nonconsenting party will attempt to belatedly join the unit. The entire rationale for the assessment of nonconsent penalties is that the party which waits to see whether drilling is successful and, when it is, then elects to join the unit in order to participate in the fruits of the endeavor, has, in effect, managed to avoid all of the risks attendant in any drilling venture. Since the nonconsenting party has effectively managed to avoid exposure to the risk of drilling, it is only fair that his return be less than the return of those who ventured to drill when ultimate success was still in issue. The nonconsent penalty is basically a mechanism for accomplishing this result.

These considerations obtain equally in the case of unleased Federal land. Thus, if the land to be leased is within the participating area of a well already successfully drilled, the prospective lessee has no risk in joining the unit as it is well aware of the successful nature of the unit well. If, on the other hand, drilling has resulted in a dry hole, any prospective lessee would take this knowledge into consideration in formulating his bid as well as in the determination of whether or not to bid at all. Under either set of circumstances, the risks which the consenting parties undertook simply do not exist for the subsequent Federal lessee. The prospective Federal lessee knows for a fact what the result of the drilling was and can be expected to take it into consideration in deciding his subsequent actions.

It is true, of course, that a rule prohibiting the imposition of a nonconsent penalty in such situations would probably increase Federal revenues since prospective bidders would also consider this aspect in formulating their bids. But the problem is that this financial gain is, in a

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fn. 2/ continued
could be achieved by amending the regulations and the Model Unit Form Agreement to expressly provide that no nonconsent penalty may be applied against a subsequent joinder where the land involved is Federal land which was unleased at the time the unit agreement was entered into. See sec. 7 of the Model Form Unit Agreement, 43 CFR 3186.1.

very real sense, being made at the expense of those individuals who were willing to hazard their own money in developing oil and gas. Thus, even granting that the Government could, by regulation, prohibit imposition of the nonconsent penalty where the Federal land was unleased at the time that the unit was established, there are a number of considerations which might militate against such an approach. 3/

However, quite apart from any question concerning what the Federal Government might do in the future, I think it clear that, insofar as this specific appeal is concerned, under the terms of the approved Hamilton Unit Agreement unleased Federal land is not committed to the unit and is, thus, not eligible for an allocation of unit production. Accordingly, I concur with the decision reached in the lead opinion.

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James L. Burski
Administrative Judge

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3/ While the foregoing discussion assumes a voluntary unitization, it should be noted that even where forced unitization occurs, the various states generally have differing procedures for either purchasing the nonconsenting parties' interest or for applying penalties for subsequent joinder attempts.